IN THE

Supreme Court of the United States

October Term, 1944 — No. .....

IN THE MATTER

OF

CHILDS COMPANY, DEBTOR

In Proceedings for Reorganization under Chapter X of the Bankruptcy Act — No. 82,868

JOHN F. X. FINN, as Trustee of CHILDS COMPANY,
Petitioner

against

THE 415 FIFTH AVENUE COMPANY, INC.,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I

The opinions below and the statement of the case are believed sufficiently set forth in the foregoing petition and in the argument herein.

II. Grounds of Jurisdiction

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, as amended by the Act of Feb-

ruary 13, 1925 (28 U. S. C. Sec. 347) and Section 24 (c) of the Bankruptcy Act.

III. Specification of Errors

The Petitioner will urge that the Circuit Court of Appeals for the Second Circuit erred:

1. In holding that a landlord's misrepresentations of its intentions made during the course of negotiations with the Trustee were immaterial and did not constitute the basis of an estoppel.

2. In failing to follow the controlling law of the State of New York as to the effect of such misrepresentations, in violation of the rule of *Erie* v. *Tompkins*, 304 U. S. 64.

3. In holding that in a Reorganization Proceeding, a delay of ten months, under the admitted facts in this case, by a landlord in exercising an option to forfeit a lease of the Debtor by virtue of the institution of Reorganization Proceedings, did not operate as a matter of law as a waiver of said option.

4. In failing to reverse the order of the District Court decreeing that the lease between the parties was terminated and directing the Petitioner and the Debtor to vacate the premises in question.

IV. Summary of Argument

The points of argument will follow the reasons relied upon for the Writ of Certiorari, and will be discussed in the order stated in the petition.

V. Argument

POINT I

The decision of the Circuit Court of Appeals, in holding that the landlord's misrepresentations of its intentions did not constitute the basis of an estoppel, is contrary to the controlling law of the State of New York, and thus contravenes the doctrine of *Erie* v. *Tompkins*, 304 U. S. 64.

There is no dispute as to the representations made by the lessor's attorneys. As heretofore shown, they have been expressly found by the Special Master (Finding 15; R. 274, 275). For convenience, the finding is here set forth:

> "In telephone conversations between Herbert Birrell and Joseph Lorenz on January 31, February 2, and February 7, Herbert Birrell in substance stated that the desirability of a lease providing for a rental which depended upon earnings would depend, to a large extent, upon the management of the Childs Company, and that this could not be known until it was known who was going to manage the Childs Company upon reorganization, and that in any event there was no need to hurry, and that it would be preferable to wait until the reorganization proceeding was further along, and that he would subsequently communicate with Mr. Lorenz regarding this matter."

Nor is there any doubt that these statements were false and were made with the sole purpose of lulling the trustee into security and inaction while the landlord was completing his negotiations with other parties with whom a new lease was ultimately made. Thus, as the Special Master found:

> "Beginning in January, 1944, and continuing until a lease was executed between the petitioner (the landlord) and a new tenant, the petitioner had offers and was considering offers from this new tenant and others" (Finding 11; R. 274).

There is no dispute that the landlord never had the slightest intention of himself considering the trustee's offer. In fact, the landlord's attorney, in an affidavit submitted in support of the proceeding to terminate the lease, not only denied that he or the landlord ever had any intention of considering said offer, but went so far as to deny that he ever made the representations (R. 30, 31). For example, in said affidavit the landlord's attorney stated:

> "My purpose in outlining these points was to show Mr. Lorenz that even to a person who was in favor of percentage leases, the one which he proposed was without merit so that I would not even recommend it to our clients and secondly that our clients had definitely indicated their position. * * * There was no statement on my part that I would discuss this situation with our client * * *" (R. 30, 31).

As we have seen, the Master in his finding above quoted rejected these statements of the landlord's attorney, but they indicate conclusively that neither the landlord nor his attorneys ever had any intention of accepting or considering in good faith the trustee's proposal.

There can be no doubt that the deception practiced upon the trustee resulted in serious injury to the Debtor's estate. The period was a critical one. Realty values in the vicinity were rising constantly and substantially (R. 273; finding 9). The trustee was presented with several alternatives. He could have assumed the lease, as modified, on January 28, 1944, as he was being pressed to do, if no better proposition were available. This he would

have done (R. 275, finding 16) if he had not been misled by the misrepresentations. Or the trustee might have obtained other premises in the vicinity. Believing that the landlord was in good faith considering the trustee's proposal, he naturally made no efforts to that end. The deception practiced by the landlord in view of the drastic increase in rental values during this period, fundamentally changed and injured the trustee's position.

Despite these facts the Circuit Court of Appeals was of the opinion that the misrepresentations were immaterial, and did not constitute the basis of an estoppel. Thus the Court said:

> "The maximum inference to be drawn from the remarks of the lessor's attorneys is that the lessor was in no hurry to come to a decision; and even if it was a misrepresentation, as the appellant contends, *because the lessor's attorneys had already decided that a rental based on earnings would be unacceptable, we do not see that that is relevant. There was no representation that the lessor would not exercise its power of termination if it should later reject the trustee's offer.*" (Italics ours.)

The Court was apparently of the opinion that such a misrepresentation was not "relevant," since the lessor did not represent that it would not exercise its power of termination if it should later reject the trustee's offer. Rephrased, the Circuit Court of Appeals felt that the fraudulent misrepresentations were immaterial since the lessor could later reject the trustee's offer and exercise its power of termination.

This conclusion of the Circuit Court of Appeals is directly contrary to decisions of the Court of Appeals of the State of New York upon this question. In ignoring the governing New York law the Court violated the rule laid down in *Erie* v. *Tompkins*, 304 U. S. 64. Petitioner does not contend that if the landlord's representations and statements had

been made honestly and in good faith that it could not have changed its mind thereafter. But as has been demonstrated, the representations were false and were not made in good faith.

The precise issue was presented and decided in *Adams* v. *Gillig*, 199 N. Y. 314. In that case, the defendant falsely misrepresented to the plaintiff that he desired to purchase a portion of a vacant lot for the purpose of building dwellings thereon. The plaintiff relied upon the defendant's honesty and good faith, and sold a portion of her property to the defendant. Defendant did not intend to carry out his representation to the plaintiff, and the plaintiff sued to cancel the deed, because of fraud. The following language of the Court (p. 321) is peculiarly pertinent:

> "The intent of Gillig was a material existing fact in this case, and the plaintiff's reliance upon such fact induced her to enter into a contract that she would not otherwise have entered into. *The effect of such false statement by the defendant of his intention cannot be cast aside as immaterial simply because it was possible for him in good faith to have changed his mind or to have sold the property to another who might have a different purpose relating thereto. As the defendant's intention was subject to change in good faith at any time it was of uncertain value. It was, however, of some value. It was of sufficient value so that the plaintiff was willing to stand upon it and make the conveyance in reliance upon it.*
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> "It is said that this decision will open the door to litigation. If that is the effect of it, then, so far as the decision asserts power in the court to prevent dishonesty, false dealing and bad faith in business transactions, it should be welcomed.
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> • • • • •

> "We do not concede the accuracy of the statement made before us on behalf of the defendant to the effect that false statements similar to the one made by the defendant to induce the execution of the deed by the plaintiff are common in business transactions, but if true, and controversies arise over the retention of the fruits of such frauds, and the fraudulent inducement is conceded or proven beyond reasonable controversy, the transaction will not have the approval and sanction of the courts." (Italics ours.)

The error of the Circuit Court of Appeals in failing to apply the New York law as above set forth went to the heart of petitioner's estoppel argument. It was the fraudulent misrepresentations of the lessor as to its intent which were relied upon by petitioner to his detriment and which furnished the legal ground for estopping the lessor from exercising its right of termination.

Not only is the decision of the Court below contrary to the controlling New York law and thus in violation of the rule of *Erie* v. *Tompkins, supra,* but, it is submitted, it is opposed by the weight of Federal authority.

See: Seven Cases *v.* U. S., 239 U. S. 510;
Rogers v. *Virginia-Carolina Chemical Co.,* 149 Fed. 1, 13, 14;
Keeler v. *Fred T. Ley & Co.,* 49 F. (2d) 872;
Arnold v. *National Aniline & Chemical Co.,* 20 F. (2d) 364, 369 (2nd Cir.).

The rule of *Erie* v. *Tompkins, supra,* made it mandatory upon the Circuit Court of Appeals to apply the law of the State of New York as to the effect of the false representations regarding the lessor's intent. Its failure to do so constitutes fundamental error.

POINT II

The decision of the Circuit Court of Appeals that in a reorganization proceeding a delay of ten months by a landlord in exercising an option to forfeit a lease by virtue of the institution of reorganization proceedings, does not constitute a waiver of such right, is erroneous as a matter of law. Such a rule would seriously impede the administration of corporate reorganizations under Chapter X of the Bankruptcy Act, and is contrary to well established principles laid down by the Supreme Court. This question involves an important principle affecting corporate reorganizations and should be determined by this Court.

The debtor filed a petition on August 26, 1943 for reorganization under Chapter X of the Bankruptcy Act. The District Court approved the petition, and appointed the petitioner, trustee in reorganization of the debtor (R. 275). Various negotiations were had between the parties, as set forth in Point I hereof. Thereafter, on June 23, 1944, approximately ten months after the trustee was appointed, petitioner received from the lessor a notice of election to terminate the lease (R. 235).

It is the contention of petitioner that, as a matter of law, in a reorganization proceeding under Chapter X, the failure of the lessor, under the circumstances here disclosed, to exercise its option to terminate a lease owned by the debtor until ten months have elapsed from the accrual of such right resulted in a waiver thereof. It is undisputed in the present case that during the period in question there was a substantial fluctuation in the rental values of real estate in the vicinity. Thus, the Special Master found that:

> "Between December, 1943 and June 23, 1944 there was a constant and substantial rise in the rental value

of real estate in the vicinity of the property covered by this lease." (Finding 9, R. 273.)

As this Court stated in an analogous situation in *Grymes* v. *Sanders* (1876) 93 U. S. 55, at page 62:

> "Where a party desires to rescind upon the ground of mistake or fraud, he must, upon the discovery of the facts, *at once announce his purpose*, and adhere to it. If he be silent, and continue to treat the property as his own, he will be held to have waived the objection, and will be conclusively bound by the contract, as if the mistake or fraud had not occurred. He is not permitted to play fast and loose. *Delay and vacillation are fatal to the right which had before subsisted. These remarks are peculiarly applicable to speculative property like that here in question, which is liable to large and constant fluctuations in value.*" (Italics ours.)

The policy announced by the Supreme Court in the *Grymes* case, involving mistake or fraud, is much more pronounced where the party asserting the right seeks to effect a forfeiture, which courts of equity abhor.

Compare,

> *Gazlay* v. *Williams, Trustee, etc.*, 210 U. S. 41;
> *Francis* v. *Ferguson*, 246 N. Y. 516.

In the "*Elevator Case*", 17 Fed. 200, a lessor claimed a forfeiture of a lease by virtue of a sub-letting of the premises without the consent of the lessor. The court held that the failure of the lessor to take prompt advantage of the breach caused by the sublease, which was alleged to be for a period of "two or three months" constituted waiver of any of the landlord's rights of forfeiture. The court stated in part (p. 202):

> "It is reasonable, it is natural, that when a contract puts into the power of one man to say that under

certain contingencies, of which he is to be the judge, he shall enter upon the house or home or property of another, and eject him instantly, and take possession, —it is reasonable, it is proper, that the contract and the acts which justify such a course of conduct shall be construed rigidly against the exercise of the right. Courts of equity, when necessary, when this power has been exercised, will come in and afford relief.

* * * * *

"It is sufficient to say, as to this, that if it was provided by the lease that this elevator should be kept in the hands of the original parties, (as it probably was,) it seems to us that the time which elapsed before the railroad company undertook to enforce their rights under that breach of the terms of the lease is enough to condone or waive it."

In *Commercial Trust Co.* v. *Wertheim Coal Co.*, 88 N. J. Eq. 143, where a forfeiture of the lease was invoked for various breaches thereof including a failure to pay taxes, the lessor, with knowledge of the breaches, took no action to enforce the forfeiture provisions for approximately eight months. The Court held, at page 151:

"This delay is, in effect, a waiver of the default in equity where forfeitures are not regarded with favor. Grigg *v.* Landis, 21 N. J. Eq. 494. Some definite action must be taken to claim a forfeiture, and it is well settled that if such action is taken after a lapse of time this constitutes a waiver of the right to declare a forfeiture. 24 Cyc. 1364. It has been held that the lessor may waive the forfeiture by neglecting to assert his right within a reasonable time after the default. 24 Cyc. 1364."

Powers Shoe Co. v. *Odd Fellows Hall*, 133 Mo. App. 229, 113 S. W. 253 (1908), closely parallels the case at bar.

The ground of forfeiture in that case was the breach of a covenant in a lease prohibiting the assignment without the consent of the lessor. The assignment was dated July 14, 1906. The tenant notified the landlord of the assignment and asked the lessor to consent to the assignment on September 9th. On October 18th the lessor served notice of its election to forfeit the lease because of the aforesaid breach. The Court found that the delay of the lessor for three months was sufficient to work a waiver of the lessor's right to declare a forfeiture. The Court stated in part:

> "If a landlord would forfeit the term for breach of contract by the lessee, he must be prompt in his declaration of forfeiture after he learns of the breach, and *cannot hold his decision in reserve to speculate for some advantage to himself, while he suffers the tenant to incur expense in the belief that he will not be disturbed.* 18 Am. & Eng. Ency. Law (2d Ed.) pp. 382, 383, and citations in notes; Carnhart *v.* Finney, 40 Mo. 449, 93 Am. Dec. 303; Hawes *v.* Favor, 161 Ill. 440, 43 N. E. 1076."

Compare, *Kelly* v. *Varnes*, 52 App. Div. (N. Y.) 100;
Catlin v. *Wright*, 13 Neb. 558.

The principles we have discussed are particularly applicable in the administration of corporate reorganizations under Chapter X. It is of paramount importance in such cases that persons holding executory contracts with a debtor in reorganization should exercise promptly any claimed right of forfeiture arising out of the filing of a petition for reorganization. Chapter X of the Bankruptcy Act was enacted by Congress to provide a more satisfactory method for the reorganization of corporations which found themselves in temporary financial straits. Its purpose was to permit the business of such corporations to be continued and their assets preserved for creditors and stockholders, rather than have them partially or wholly

destroyed by proceedings in bankruptcy or equity receiverships. In innumerable instances, corporate contracts, including leases, constitute assets which, in many cases, are vital to the continuance of the business.

If the decision herein of the Circuit Court of Appeals should in such situations be followed, the administration of proceedings under the Act and the possibility in many cases of a successful reorganization, will be substantially impaired. No plan of reorganization can be promulgated in a situation where the trustee does not know whether or not valuable executory contracts of the debtor will be cancelled.

With respect to the exercise of a right of cancellation in a reorganization proceeding, time is definitely of the essence. The very nature of such a proceeding should make it mandatory that lessors exercise their rights of termination promptly or else such right should be deemed waived by delay in its exercise. Certainly the lessor should not be permitted to hold such right of termination in abeyance and exercise it at his convenience or best advantage. The trustee in such a situation cannot assume the lease, since his affirmation of the lease is subject to the right of cancellation. On the other hand, if the lessor desires a speedy determination as to whether the trustee will assume the lease, he can follow the customary practice of applying to the Court for an order requiring the trustee to assume or reject the lease within such time as may be fixed by the Court. (*cf. Green* v. *Finnegan Realty Co.*, 70 F. (2d) 465, 466, 5th Cir.)

Certainly, in any event, a lessor should not be permitted to hold off the trustee, and, by means of misrepresentations of his intentions, as discussed in Point I, lull him into security, while in a rising and speculative market, the lessor negotiates with other parties without disclosing that fact to the trustee (R. 274; Finding 12). Under these circumstances, it seems clear that the rule of the Supreme Court in *Grymes* v. *Sanders, supra,* must be applied.

Petitioner submits, therefore, that the decision of the Circuit Court of Appeals, under the circumstances above set forth, to the effect that an option of termination is not waived by failure to exercise it promptly, is unsound both from a legal and practical viewpoint, and would seriously hamper the administration of Chapter X of the Chandler Act.

This aspect of corporate reorganization law has never been passed upon by this Court, either with respect to Section 77B or its successor, Chapter X of the Bankruptcy Act. It involves a question of vital importance in the administration of corporate reorganizations.

CONCLUSION

It is respectfully submitted that the petition for certiorari should be granted.

Dated: April 5, 1945.

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